

# California's 2013-14 Budget



April 20, 2013

# Roadmap for Today's Presentation

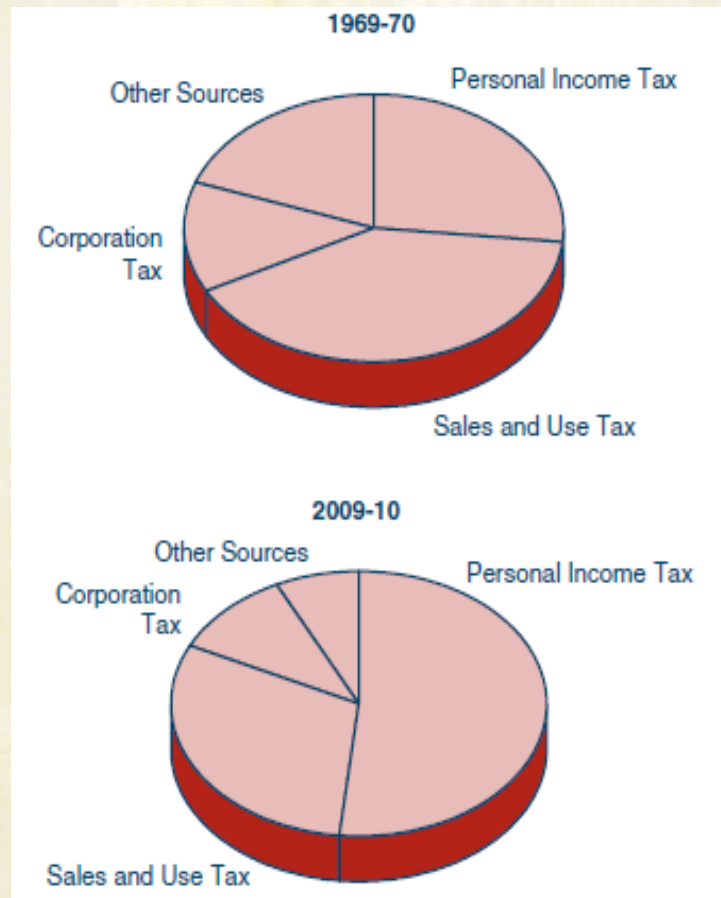
- Start with context on the budget, revenues, and expenditures.
- Consider the dynamics of this year's budget process.
- Discuss several key proposals in the Governor's January budget.
- Review several key considerations with the proposed budget.
- Finish with questions/answers.



# State Budget at a Glance

- 161 different state departments.
- \$138.6 billion in proposed total spending (\$97.7 billion State General Fund).
- Roughly 670 different special funds.
- About 357,000 authorized positions.
- Over 70 percent of General Fund not spent at the state level and instead passed on to other governmental bodies at the county, city, and special district level.

# Composition of Revenues



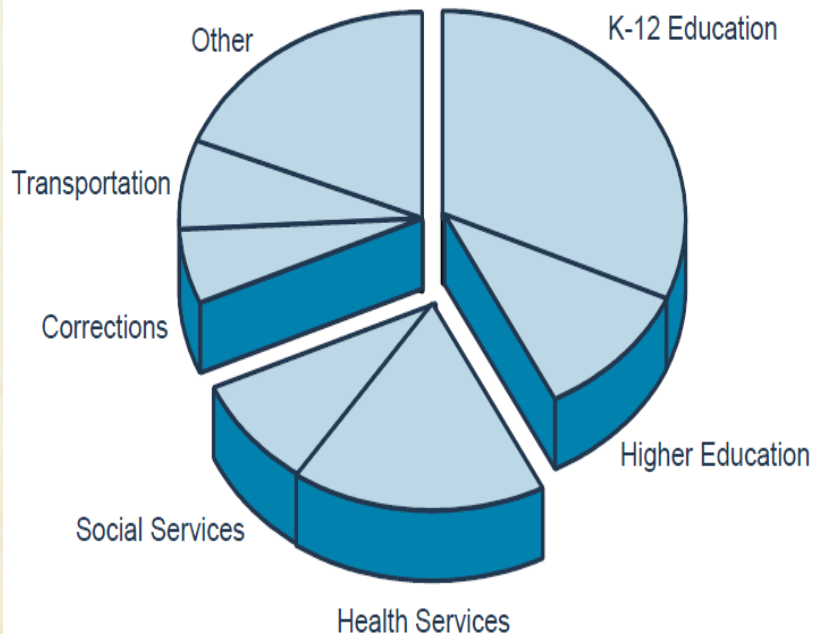
- Over the past four decades, personal income tax revenues to the General Fund have increased dramatically—rising from 27 percent to 51 percent of General Fund revenues.
- This growth is due to growth in real incomes, the state's progressive tax structure, and increased capital gains.
- The reduced share for the sales tax reflects in part the increase in spending on services, which generally are not taxed.



# Composition of Expenditures

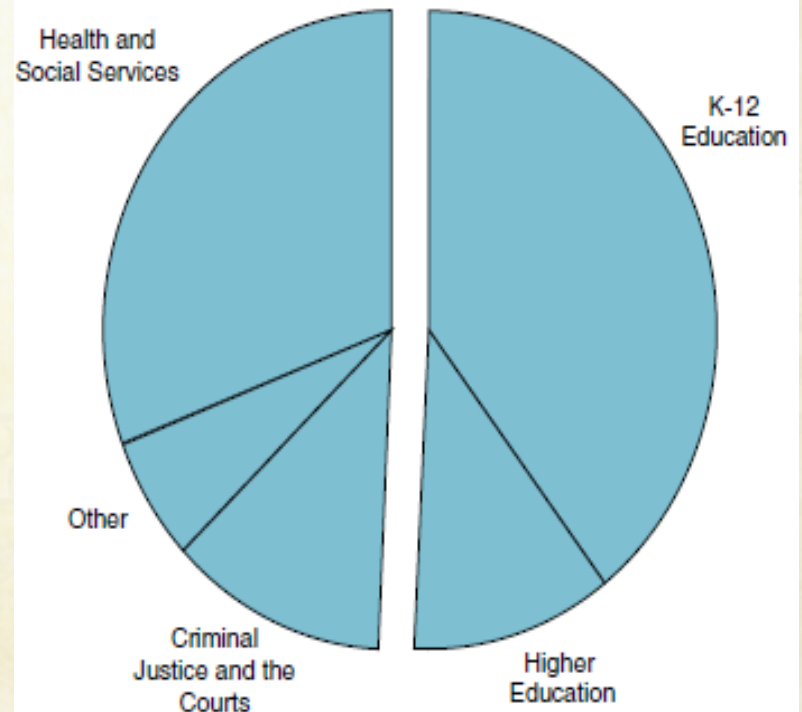
## Education and Health and Social Services Dominate Spending

2000-01



## Education Makes Up Half of State Spending

General Fund—2011-12



# 2013 Budget Dynamics

- After years of budget cutting and fiscal turmoil, California's budgetary situation is largely stable and the state's credit rating is improved...
- ...but many uncertainties remain:
  - Economic conditions improving, but still shaky.
  - Future actions in Washington on “sequestration” and federal budget could affect the state's budget.
  - State's revenues are more dependent than ever on Personal Income tax, which is volatile and difficult to project, and thus...
  - ...April 15 revenue collections—and the accompanying May Revision—could alter the situation.



## 2013 Budget Dynamics (con't.)

- If everything holds close to current projections, State's budget looks to have surpluses in the longer-term...
- ...but the longer-term plans embedded in the Governor's Budget, including greater investment in K-12, higher education, healthcare, and debt buy-down, expend most of the future surpluses.
- While Governor's Budget proposals would reduce "Wall of Debt," considerable amount remains, as well as longer-term fiscal liabilities, like retiree health, State Teachers Retirement System, etc.

## 2013 Budget Dynamics (con't.)

- Governor's Budget assumes a \$1 billion reserve (relatively healthy, but still equivalent to only about 1% of revenues), but does not assume any deposits into the Prop. 58 Budget Stabilization "rainy day" Account over the next 4 years...
- ...and given current projections and the Governor's proposals, to add to the rainy day fund would require spending less than proposed on things like higher education, health, debt buy-down, or by making cuts or raising revenues.



## 2013 Budget Dynamics (con't.)

- Intricacies of Prop. 98 will require that a vast amount of future General Fund revenue growth must go to K-14 education—a good thing, but...
- ...that leaves less for other General Fund programs and priorities, such as Health & Human Services, higher education, etc.
- Governor's Budget begins some important funding restorations, particularly in K-12 education and higher education, and expands health care coverage for the uninsured, but...

## 2013 Budget Dynamics (con't.)

- ...does little to restore previous difficult cuts to the “safety net” and other programs.
- Many state employee contracts expire this year, and the budget makes no assumptions about collective bargaining agreements, so...
- ...any new contract costs that are bargained will need to be paid for.
- Many budget-related issues still pending before state and federal courts (worth several hundreds of millions of dollars), and the outcomes of cases could change dynamics substantially.



# How Does the Governor Pay Down the “Wall of Debt”?

- Mostly modest payments in 2013-14, more payments in the out-years.
- Biggest payments are automatic (Economic Recovery Bonds), or have limited alternative use, like Prop. 98 funds, which can only go for education.
- The most discretionary areas of payments are for special fund borrowing, local government mandates, and other state deferrals—and the bulk of those payments are in the out-years.

# Governor's "Wall of Debt" Payments

(billions of dollars)

	<u>Current Wall</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>What Remains</u>
Deferrals to schools, CCCs	\$8.2	<b>\$2.0</b>	\$3.0	\$3.1	\$0.1	--
Economic Recovery Bonds	5.2	<b>1.5</b>	1.6	1.7	0.3	--
Borrowing: Special Funds	4.1	<b>0.6</b>	0.8	2.2	0.6	--
Mandate payments	4.9	--	--	0.2	2.2	2.5
Underfunding of Prop. 98	2.4	--	0.2	--	2.1	--
Deferred Medi-Cal payments	1.7	<b>0.1</b>	0.3	0.1	--	1.1
Deferred state payroll costs	0.7	--	--	--	--	0.7
Deferred payments to PERS	0.4	--	--	--	0.4	--
Borrowing: transportation	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>--</u>	<u>--</u>
	\$27.8	<b>\$4.2</b>	\$6.0	\$7.3	\$5.8	\$4.3



# What About Revenue Collections?

- **\$6.2 billion up:** As of April 18, personal income tax receipts were about \$6.2 billion above projections for the current fiscal year.
- **But caution:** LAO and DOF advise caution, some (perhaps most) of the additional 2012-13 receipts likely are connected to taxable income “accelerated” from 2013 (or later) back to 2012 due to the lower federal tax rates that were in effect at the time.
  - If maintained, these accelerations may result in increased 2011-12 and 2012-13 state revenue above projections, but potentially result in a decrease in revenues that would otherwise have occurred in 2013-14 (and in the out years).
- **And then there is Proposition 98...**

# Revenues and Impact of Proposition 98

- LAO also cautions that the improved revenue may not help the state's financial bottom line in the current year because the revenue boost could result in a major increase in the state's Proposition 98 school funding minimum guarantee in 2012-13 by a similar amount, maybe as much as 90%, to pay off “Maintenance Factor” obligations.
- Going forward, the greater the year-to-year increase in revenues, the greater the Proposition 98 guarantee.



# Many Fiscal Liabilities Still on the Long-Term Horizon

Federal loans for Unemployment Ins:	\$10 billion
State retiree health benefits:	62 billion
State employee pensions:	39 billion
Teacher pensions:	65 billion
UC employee pensions:	13 billion
Judges' pensions:	<u>3 billion</u>
<b>Total:</b>	<b><i>\$191 billion</i></b>

# **Key Budget Proposals: K-14 Education (Proposition 98)**

- Overall, increases by \$2.8 billion, or about 5%
- Pays down deferrals (\$1.9 billion), year one of a four year plan.
- Transitions to new K-12 funding formula (\$1.6 billion) – “Local Control Funding Formula.”
- General purpose money for CCCs (\$197 million).
- Allocates Prop. 39 money for K-14 schools/colleges energy efficiency (\$450 million).
- Augmentation for Adult Education (\$300 million).
- Additional funding for K-12 mandate block grant (\$100 million).



# K-12 Local Control Funding Formula

- Major restructuring of state funding for schools districts, charter schools, and county offices of education.
- Replaces existing Revenue Limit and Categorical Program funding with simple formula: uniform per-pupil rates and supplemental funding for certain groups of students.
- New formula begins in 2013-14; 7 year phase in.
- When fully implemented, all districts would receive more funding than they do today, but...
- ...that is partly a function of the projected growth in Proposition 98 and restoration of Revenue Limit and COLA funds.

# K-12 Local Control Funding Formula

*Governor's proposal has some strengths...*

- Relatively simple & transparent.
- Heightens state focus on educationally disadvantaged students.
- Draw closer linkage of funding to costs.
- Provides flexibility to address local priorities.
- Places emphasis on students, not on complying with spending rules.



# K-12 Local Control Funding Formula

*...but also some weaknesses*

- Doesn't consider what is “adequate” funding level for all students.
- Limited accountability provisions to ensure that funding is spent for targeted students.
- Excludes two of the largest, most outdated categorical programs.
- Does not protect investments in facilities.
- Major policy changes proposed in conjunction with the budget, which is required to pass by June 15.

## Key Budget Proposals: *Higher Education*

- Overall, increases by about 5%.
- Mostly base increases in the 3 segments.
- Proposes no tuition increases in UC, CSU, or CCC.
- Proposes multi-year plan to increase state support for 3 segments.
- Proposes to cap number of units that state will subsidize.
- Designates funds in all 3 segments to expand distance education.
- Proposes to move Adult Education to CCCs.



# Key Budget Proposals: *Health*

- Proposes full implementation of federal Affordable Care Act (ACA).
- Sets aside \$350 million for preliminary implementation of required changes under the ACA.
  - Assumes enactment in a Special Session of the Legislature.
- Assumes California will, in fact, expand Medi-Cal to uninsured (optional to states under U.S. Supreme Court decision).
  - Offers two different options to pay for it in the long-term, both of which require capturing savings counties will experience as a result of drop in county costs for indigent care.
  - Assumes that this implementation would take some time.

## Key Budget Proposals: *Other*

- ***CalWORKs:*** Includes \$143 million for expanded job services.
- ***Courts:*** Provides \$200 million for court operations, but redirects the same amount from court construction funds to maintain same General Fund savings.
- ***Corrections:*** Continues implementation of the “Blue Print,” but does not include any changes relative to recent federal court filings on prison population caps.
- ***In-Home Supportive Services:*** Assumes implementation of existing law cuts, but make no new cuts.



## Key Budget Proposals: *Other (con't.)*

- ***Veterans Affairs:*** Provides funding to open two new Veterans Homes, in Fresno & Redding.
- ***State Employees:*** Existing contracts fully funded; no funds included for salary or benefit increases that might come about as a result of new contracts.
- ***Enterprise Zones:*** Budget includes \$60 million in revenue from recent changes in regulations which eliminate “retro-vouchering.”
- ***State’s Cash Position:*** Much improved; no new deferrals of payments to schools or local governments.

# Key Considerations

- May Revision is the next process milestone; followed by June 15 constitutional deadline.
- Governor's priority for new \$\$ – proposed augmentations for higher education and health.
- The “Wall of Debt” – should other debts be a higher priority for pay off?
- What about a multi-year approach to budgeting, given longer term revenue growth and uncertainties?



## Key Considerations (con't.)

- How does the state balance the notion of greater long-term fiscal capacity against all of the budgetary uncertainties (revenues, the economy, federal funding)?
- What is the priority for making deposits to the “rainy day fund?”
- Does the state need to address the other, longer-term liabilities (retiree health, STRS, etc.)?
- And what about federal sequestration and the federal budget? How might that affect California?

# Questions and Answers